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TREASURY FOR JEFF BAKER AND LARRY NORTON

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SUBJECT: ECONOMIC LEADERS: MINORITY GOVERNMENT, REFORMS ON
HOLD

Classified By: Ambassador April H. Foley for reasons 1.5 (b) and (d).

¶1. (C) Summary: Economic leaders, led by Finance Minister Veres and National Bank Governor Simor, appear to be moving on with preparations for a minority government under the continued leadership of Prime Minister Gyurcsany. The government changes are of particular concern from an economic perspective because of the widespread belief in the business and financial sectors that further structural reforms are needed in order for Hungary's economy to return to healthy growth levels. From the economic side, a consensus has emerged: a minority government will likely maintain fiscal discipline but does not have the political ability to push through any deepening of the reforms; from an economic/reform perspective, status quo policies will almost certainly stay in place until the next elections. With status quo policies come status quo conditions on financial markets, so little market disruption is expected after the coalition breakup is finally sorted out. This belief is so widely held that it appears to discount to the point of dismissal the proposal that a temporary technocrat government could assume power. End summary.

Veres Seeks to Reassure

¶2. (C) In a heavily attended and well-publicized April 3 breakfast meeting co-hosted by virtually every international chamber of commerce in Budapest, Finance Minister Veres divided his time between presenting his current economic plan and addressing concerns about the ongoing schism within the SzDSz-MSzP governing coalition, patiently answering question after question afterwards. In what appeared to be a direct plea to financial markets, he insisted repeatedly that the government is committed to meeting its deficit target, and that it will continue on a path closely targeting the European Union convergence criteria, though progress on the path may be slowed somewhat by declining worldwide growth and the increase in risk premium Hungary pays on its sovereign debt. With SzDSz out of the coalition, he posited, the government would propose far fewer pieces of legislation, but will seek multi-party support for the common goals of a fiscally responsible 2009 budget and an updated Convergence Program this year for the European Union.

¶3. (C) The Veres message did little to soothe business leaders in the audience, who expressed extreme frustration at the slow pace of fiscal tightening, continuing corruption issues, and the evaporation of hopes for a tax cut promised just weeks ago. Veres agreed that sweeping reforms, such as halving the size of central government as recommended by former Finance Minister Bokros, are an "optimal" approach, but said that the government could only do what is realistic

in terms of both determined Fidesz opposition to Socialist policies and deep divisions within MSzP itself. He concluded flatly, "deepening of reforms is not possible at this time."

A Technocrat Explains Why Technocracy Won't Work

¶4. (C) In an April 3 meeting with Ambassador Foley, National Bank Governor Andras Simor explained why he envisions the status quo economic and reform policies to be the only realistic outcome for Hungary. Acknowledging rumors of his own status as a possible caretaker Prime Minister, he said that the key ingredient for a successful technocratic government is missing: nearly universal political backing in order to ensure that reform legislation passes. With no end in sight to partisan bickering between Fidesz and MSzP, the needed "shock treatment" of widespread parallel reforms simply would not be possible. Without widespread backing, Simor argued that no technocrat would be willing to take the job. What remains is a weakened Socialist minority government with no willingness to undertake reform. Simor went on to say that public trust in a leader would be an essential element for public support for further austerity measures. In that respect, he finds both Gyurcsany and Fidesz chief Viktor Orban lacking.

¶5. (C) In terms of finding the right reform solution, Simor expressed confidence that he and other experts have adequate access to decision-makers. In fact, Simor held the view that Gyurcsany personally supported large-scale reforms, but that political realities prevented him from implementing his plans. Simor described shifting his own activities to public outreach, making media appearances and encouraging business leaders to publicly express their concerns about the government and need for reform. This is one way Simor sees to reach the grassroots voters, who otherwise don't naturally

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connect a good or poor investment climate with their day-to-day lives. (Note: Former Minister of Justice and Law Enforcement Albert Takacs shares Simor's assessment that a minority government is the probable outcome of the current impasse. He notes, however, that Simor's outreach efforts have raised eyebrows among many in the MSzP, who see his high public profile as inappropriate. Takacs believes Simor's perceived politicking has actually undermined support for him to head a possible "government of crisis management." End Note.)

And, for the Economy, Few Changes, if Any

¶6. (C) In discussing the benchmark interest rate, currently set at 8 percent by the Monetary Council, Simor declined to support further increases in the benchmark until the market "begins to find its equilibrium." This is a shift from his comments in mid-March that the benchmark rate needs to rise to be closer to market expectations, and reflects the economic handicapping of the political situation in Hungary. Both the head of Hungary's largest OTP Bank, Sandor Csanyi, and Minister Veres, speaking privately to Ambassador Foley, said that they were looking for a quick resolution, within two to three weeks, of the ruling coalition breakup and resolution of whether Gyurcsany stays or goes. Simor quoted an on-line survey of economic analysts, according to a majority of whom, a minority Gyurcsany government would remain in power, and that this would result in no change from status quo policies or status quo market conditions. Local market analysts, including Eszter Gargyan, who oversees Citi Hungarian government security markets, have been quick to highlight their "no change" projections for the Hungarian economy. While business leaders had been hoping for tax relief, it turns out that leading market analysts were already making their projections on a no tax relief basis. While the political situation remains unresolved on many levels, markets have already signaled their expectations: continued slower than trend growth with unfinished reforms, high tax, and inefficient government in Hungary.

